

COMMONWEALTH OF KENTUCKY
BEFORE THE UTILITY REGULATORY COMMISSION

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In the Matter of:

THE APPLICATION FOR AN ADJUSTMENT)	
OF THE SANITARY SEWER RATES AND)	
CHARGES FOR THE G.H.K. SEWAGE CO.,)	CASE NO. 7556
INC., JEFFERSON COUNTY, KENTUCKY)	

O R D E R

Preface

On August 21, 1979, G.H.K. Sewage Company, Inc., hereinafter referred to as the Utility, filed with this Commission its petition seeking approval of a proposed increase in its sewage service rates.

The case was set for hearing at the Commission's offices in Frankfort, Kentucky, January 15, 1980. All parties of interest were notified with the Consumer Protection Division of the Attorney General's Office intervening in this matter. At the hearing certain requests for additional information were made by the Commission staff. This information has been filed, and the entire matter is now considered to be fully submitted for a final determination by this Commission.

Test Period

The Utility has selected the twelve month period ending June 30, 1979, as the "Test-Year" and has submitted tabulations of its revenues and expenses for this period including its proforma adjustments thereto for the Commission's consideration in the determination of rate adjustments. Said tabulations along with those found reasonable by this Commission are included in Appendix "C" of this Order.

Rate Determination

While the Commission has traditionally considered the original cost of utility plant, the net investment, the capital structure and the cost of reproduction as a going concern, in determinations of fair, just and reasonable rates; its experience in the establishment or adjustment of rates for sewage utilities

has indicated that these valuation methods are not always appropriate. Sewage utilities are unique to the extent that the cost of facilities has usually been included in the cost of the individual lot. The owner, and/or operator of the utility is, in many instances, the developer of the real estate and title may have changed hands prior to the effective date of Commission jurisdiction (January 1, 1975). Further, the Commission has found that the books, records and accounts of these operations are, for the most part, incomplete, so as to make impossible the fixing of rates on the above methods of valuation. Therefore, the Commission is of the opinion that the "Operating Ratio"⁽¹⁾ method should be utilized for the establishment or adjustment of rates for sewage utilities although it is recognized that there may be instances where other methods could be utilized.

Findings in This Matter

The Commission, after consideration of all the evidence of record and being advised, is of the opinion and finds:

1. That in this instance, the determination of rates and revenue requirements should be based on the operating ratio method.
2. That the existing rate of the Utility produced total revenues of \$33,412 from an average of 313 customers receiving sewage disposal services during the test year. Further, that the Utility's expenses of \$36,262 for this period resulted in a test year deficit of \$2,850.
3. That the rates as prescribed and set forth in Appendix "A", attached hereto and made a part hereof, should produce gross annual revenues of \$58,800 from 500 customers and are the fair, just, and reasonable rates to be charged for sewage services rendered by the Utility to customers located in its service area. Further, the Appendix "A" rate for single-family residential service is the same rate prescribed by this Commission by Order entered September 20, 1976 in Case No. 6465.
4. That the rates proposed by the Utility are unfair, unjust, and unreasonable in that they would produce revenues in excess of those found reasonable herein and should be denied.

(1) Operating ratio is defined as the ratio of expenses, including taxes to gross revenues.

$$\text{Operating Ratio} = \frac{\text{Annual Expenses including Taxes}}{\text{Annual Gross Revenues}}$$

5. That an operating ratio of approximately 0.88 will result from the revenues produced by 500⁽²⁾ customers and should provide a reasonable return margin⁽³⁾ in this instance.

6. That while traditionally depreciation on contributed property for rate-making purposes has been allowed, it has not been a matter of great significance in past years. The value of contributed property in currently operating water and sewage utilities, however, is frequently more than the value of investor financed property. Further, it is common practice for a land developer to construct water and sewage facilities that add to the value and salability of his subdivision lots and to expense the investment cost thereof in the sale price of these lots or, as an alternative, to donate these facilities to a utility company.

It is also recognized that many residential and commercial developments in metropolitan areas are served by privately-owned sewage systems. Further, that federal guidelines will require the incorporation of these sewage systems into a regional comprehensive sewer district at such time as connecting trunk lines are made available. Further, that to permit the accumulation of a depreciation reserve on contributed property that is to be abandoned would not, in our opinion, be in the public interest.

The Commission is, therefore, of the opinion and finds that depreciation on contributed property for water and sewage utilities is not justified and should not be included in rate-making determinations for these utilities. In support of this position and by way of substantiation, we make reference to the cases and decisions listed in Appendix "B", attached hereto and made a part hereof.

7. That the Commission after considering the tabulation of test-year and projected revenues and expenses submitted by the Utility concludes that said revenues, expenses, and proforma adjustments can be summarized as shown in Appendix "C", attached hereto and made a part hereof. On the basis of the said Appendix "C" tabulation, the Commission further concludes that annual

(2) The Commission's determination of revenues is based on the Utility's plant capacity: a 200,000 GPD plant can accommodate 500 residential lots at 400 GPD per lot.

(3) Return margin is the amount remaining for the payment of a return on the investment of the security holders.

operating revenues in the amount of \$58,800 are necessary and will permit the Utility to meet its reasonable expenses for providing sewage collection and disposal services for its customers.

Orders in This Matter

The Commission on the basis of the matters hereinbefore set forth and the evidentiary record in this case:

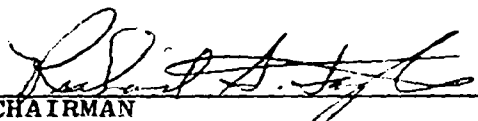
HEREBY ORDERS that the rates prescribed and set forth in Appendix "A", attached hereto and made a part hereof, be and they are hereby fixed as the fair, just, and reasonable rates of the Utility for providing sewage disposal services to customers located in its service area and shall become effective for services rendered on and after the date of this Order.

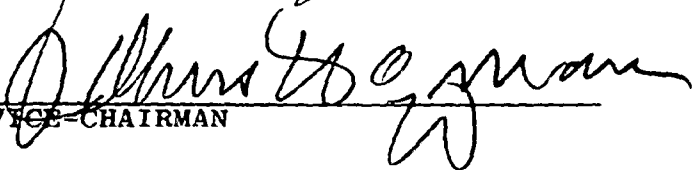
IT IS FURTHER ORDERED that the rates sought by the Utility be and the same are hereby denied.

IT IS FURTHER ORDERED that the Utility shall file with this Commission, within sixty (60) days from the date of this Order, its tariff sheets setting forth the rates approved herein. Further, that copies of all the Applicant's rules and regulations for providing service to customers located in Jefferson County, Kentucky shall be filed with the said tariff sheets.

Done at Frankfort, Kentucky this 19th day of March, 1980.

UTILITY REGULATORY COMMISSION


CHAIRMAN


VICE-CHAIRMAN


COMMISSION

ATTEST:

Secretary

APPENDIX "A"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY
COMMISSION IN CASE NO. 7556 DATED MARCH 19, 1980

The following rates are prescribed for sewage disposal
services rendered to customers of the G.H.K. Sewage Company, Inc.
located within its service area of Jefferson County, Kentucky

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
Single-Family Residential	\$ 9.80 Per Residence
Multi-Family Residential	7.35 Per Apartment
All Other	19.60 Per Residential Equivalent ⁽¹⁾

(1) The number of residential equivalents and/or fractional parts thereof shall be determined by dividing the customer's average monthly water consumption in gallons by 12,000 gallons. The minimum bill for this type service shall be \$9.80

APPENDIX "B"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY
COMMISSION IN CASE NO. 7556 DATED MARCH 19, 1980

A listing of cases and decisions that substantiate finding
number 6.

- (1) 28 U.S.C. s 362(c) (1976).

Dealing with the Basis to Corporations in Reorgani-
zation. It states in part that property contributed
by nonstockholders to a corporation has a zero basis.

- (2) Easter v. C.I.R., 338 F.2d 968 (4th Cir. 1964).

Taxpayers are not allowed to recoup, by means of de-
preciation deductions, an investment in depreciable
assets made by a stranger.

- (3) Martigney Creek Sewer Co., (Mo. Pub. Serv. Comm.,
Case No. 17,117) (November 26, 1971).

For rate making purposes a sewer company should not
be allowed to treat depreciation on contributed plant
as an operating expense.

- (4) Re Incline Village General Improv. Dist., I & S 558,
I & S 559, (Nev. Pub. Serv. Comm., May 14, 1970).

Where a general improvement district sought to in-
crease water rates, the Commission could not consider
depreciation expense on the district's plant because
all of the plant had been contributed by members of
the district.

- (5) Princess Anne Utilities Corp. v. Virginia ex. rel.
State Corp. Commission, 179 SE 2d 714, (Va. 1971).

A depreciation allowance on contributions in aid of
construction was not allowed to a sewer company
operating in a state following the "original cost"
rule in determining rate base because the company
made no investment in the property, and had nothing
to recover by depreciating the donated property.

APPENDIX "C"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY COMMISSION IN CASE NO. 7556 DATED MARCH 19, 1980

In accordance with Finding No. 7, the following tabulation is the Commission's summary of the "Test Year" and projected annual revenues and expenses for the Applicant's 200,000 GPD sewage treatment plant and sewage collection system located in Bullitt County, Kentucky and which provided sewage disposal services to an average of 313 customers during the Test Year. Proforma revenues and expenses found reasonable are based on the plants capacity of 500 residential equivalents.

	Test Year ⁽¹⁾ 7/1/78 - 6/30/79	Proforma ⁽¹⁾ Requested	Proforma Found Reasonable
(Average No. of Customers)	(313)	(500)	(500)
<u>Revenues:</u>			
Monthly Service Fees	\$ 33,412	\$107,024	\$ 58,800
Other Revenues	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
Total Revenues	\$ 33,412	\$107,024	\$ 58,800
<u>Expenses:</u>			
1. Management & Office			
a) Managers salary		8,100	1,800 ⁽²⁾
b) Bookkeeping		1,920	1,200 ⁽³⁾
c) Office rent & utilities	} 7,600	1,200	1,200
d) Telephone		180	180
e) Supplies, postage, etc.		600	400 ⁽⁴⁾
2. Billing & Collecting	1,177	3,761	2,065 ⁽⁵⁾
3. Sewage System Operations:			
a) Routine O & M (Contract)	3,500	8,021	4,200 ⁽⁶⁾
b) Sludge hauling	630	2,040	2,040
c) Repairs & maintenance (not included in 3a above)	968	6,581	6,581
d) Utilities - electric	8,946	38,552	15,000 ⁽⁷⁾
e) Utilities - water	1,680	4,838	4,838
f) Chlorine & plant supplies	511	1,500	1,500
g) Health Department Fees	1,200	1,200	700 ⁽⁸⁾
h) NPDES Monitoring	-0-	400	400
4. Professional Services:			
a) Accounting - Annual	-0-	500	500
b) Legal - Annual	-0-	500	500
c) Engineering - Annual	4,800	5,100	1,200 ⁽⁹⁾
d) Accounting - Rate Case	-0-	367	367
e) Legal - Rate Case	-0-	833	500 ⁽¹⁰⁾
f) Engineering - Rate Case	-0-	800	500 ⁽¹⁰⁾
5. Taxes:			
a) Income - Fed. & State	1,692	2,703	1,846 ⁽¹¹⁾
b) License Fees, etc.	3,042	4,860	3,042 ⁽¹²⁾
6. Insurance	350	500	500
7. Miscellaneous	<u>166</u>	<u>500</u>	<u>500</u>
Total Expenses	\$ 36,262	\$ 95,556	\$ 51,559
Net Income (Loss)	(\$ 2,850)	\$ 11,468	\$ 7,241

APPENDIX "C" FOOTNOTES

CASE NO. 7556

- (1) Test Year and Proforma Requested revenues and expenses were taken from the statement of revenues and expenses submitted by the Utility for the twelve (12) month period ended June 30, 1979.
- (2) An allowance of \$1,800 was considered more reasonable than the requested \$8,100 for the Manager's salary for this Utility on the basis of salaries currently being paid for similar service in Jefferson County.
- (3) The Commission considers \$1,200 to be a more reasonable allowance for bookkeeping expense in this instance based on actual expenses for similar sized utilities operating in Jefferson County.
- (4) The allowance of \$400 for supplies, postage, etc. was found reasonable on the basis of actual expenses of similar utilities operating in Jefferson County and the Utility failed to adequately substantiate the requested \$600 for this expense.
- (5) The expense for billing and collecting in the amount of \$2,065 was based on apportionment of the Louisville Water Company's charges for 3,000 bills per year for both water service and sewage disposal services.
- (6) The \$4,200 allowance for routine operations and maintenance is in accordance with the Utility's contract with Andriot-Davidson. A copy of said contract is a part of the record in this matter.
- (7) The Commission is of the opinion and finds \$15,000 to be an adequate proforma allowance for electrical power costs for this Utility. The record in this matter does not adequately substantiate the requested \$38,552.
- (8) The current annual fee that is charged this size utility by the Louisville and Jefferson County Board of Health is \$700.
- (9) The Utility did not adequately substantiate the requested \$5,100 for engineering services. The Commission finds \$1,200 to be a more reasonable allowance for this expense. The cost of engineering services for construction should either be recouped from lot sales or capitalized and depreciated.
- (10) The Commission finds that no more than \$1,500 of the \$2,500 requested rate case expense for legal fees and no more than \$1,500 of the \$2,400 requested rate case expense for engineering fees should be borne by the Utility's customers; and further that these expenses should be prorated over three (3) years.
- (11) The combined federal and state income tax liability for the revenues made possible by the rates approved by this Order has been computed as \$1,846.
- (12) The Utility's test-year expenses of \$3,042 is the same as the Commission's proforma allowance for license fees, etc. expense as the Utility's requested proforma was not adequately substantiated by the record in this matter.